

**Audit of the Department of the Treasury's  
Fiscal Years 2002 and 2001  
Financial Statements**

OIG-03-014

November 15, 2002



**Office of Inspector General**

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**The Department of the Treasury**

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## **Section II - Department of the Treasury’s Performance and Accountability Report for Fiscal Year 2002**

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INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY  
WASHINGTON

November 15, 2002

**MEMORANDUM FOR SECRETARY O'NEILL**

**FROM:** Jeffrey Rush, Jr. /s/  
Inspector General

**SUBJECT:** Report on the Department of the Treasury's Financial  
Statements for Fiscal Years 2002 and 2001

**SUMMARY**

The attached report presents the results of our audits of the Department of the Treasury's (the Department) financial statements as of and for the fiscal years (FY) ending September 30, 2002 and 2001. These audits are required by the Chief Financial Officers Act of 1990 (CFO Act), as expanded by the Government Management Reform Act of 1994 (GMRA). The Department's FY 2002 and 2001 financial statements, and our audit report thereon, are incorporated in the accompanying *Department of the Treasury Performance and Accountability Report for Fiscal Year 2002*.

We have issued unqualified opinions on the Department's FY 2002 and 2001 financial statements.

Our report discusses four material weaknesses in internal control identified during our audit. The material weaknesses relate to: 1) financial management and reporting at the Internal Revenue Service (IRS); 2) electronic data processing (EDP) controls, most notably at the IRS, United States Customs Service (Customs), the Financial Management Service (FMS) and the United States Mint; 3) management of trade activities and related systems at Customs; and, 4) FMS' controls over outstanding checks.

We reported that the Department's financial management systems are not in substantial compliance with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA). The Department also determined, through its self-

assessment, that its financial management systems are not in substantial compliance with the requirements of FFMIA.

In accordance with generally accepted government auditing standards, the Report of the Office of Inspector General is dated November 8, 2002, the last date of audit field work.

## **DISCUSSION**

The Department is to be congratulated for its extraordinary accomplishment in accelerating the issuance of its report to November 15, 2002, while maintaining an unqualified audit opinion. This is more than three months ahead of last year's schedule, and two years in advance of the Office of Management and Budget's requirement that FY 2004 reports be submitted by November 15. This achievement has clearly established the Department as a leader in this regard.

While this is a truly remarkable accomplishment, costly and labor-intensive procedures were still necessary to produce reliable financial statements, albeit within a shorter time frame. Only limited progress has been made in addressing major longstanding financial management and systems deficiencies that persist at key bureaus. Also, new material weaknesses were identified at Customs and FMS.

The Department has taken steps to address material weaknesses and other deficiencies, however, these efforts need to be intensified and broadened. In addition to focusing on correcting conditions identified in prior years, the Department should take a proactive approach and assess controls throughout the year. A rigorous ongoing program of evaluating internal controls should be an integral part of management's overall internal control structure. Stated another way, one of management's goals should be to discover and correct internal control problems before they are reported by the auditors.

Achieving the financial management objectives of the President's Management Agenda continues to be a formidable challenge that will require determined leadership by the Department, full commitment of bureau heads, and highly focused efforts by financial managers and staff. Your personal support is essential for the Department to meet these challenges and achieve true financial management excellence. We are strongly committed to working with you to achieve this goal.

In accordance with the Department of the Treasury Directive No. 40-01, we request a corrective action plan be provided to us within 30 days of the date of this memorandum. We recognize that certain corrective actions have already been undertaken. We encourage these efforts and will continue to provide advice and assistance to the Department in this regard.

Should you or your staff have questions, you may contact me at (202) 622-1090 or a member of your staff may contact William H. Pugh, Deputy Assistant Inspector General for Audit, at (202) 927-5430.

#### Attachments

cc: Edward R. Kingman, Jr.  
Assistant Secretary for Management and Chief Financial Officer

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**SECTION I –**  
**REPORT OF THE OFFICE OF**  
**INSPECTOR GENERAL**



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To the Secretary of the Treasury:

We audited the Department of the Treasury's (the Department) Consolidated Balance Sheets as of September 30, 2002 and 2001, the related Consolidated Statements of Net Cost and Custodial Activity for the years then ended, and the related Consolidated Statements of Changes in Net Position and Financing, and Combined Statement of Budgetary Resources for the year ended September 30, 2002. These financial statements are incorporated in the accompanying *Department of the Treasury Performance and Accountability Report Fiscal Year 2002 (FY 2002 Performance and Accountability Report)*.

### Results in Brief

This report presents our unqualified opinion on these financial statements. Our audit disclosed the following material weaknesses in internal control:

- Financial Management and Reporting at the Internal Revenue Service (IRS) Needs Improvement (Repeat Condition).
- Electronic Data Processing (EDP) Controls Over Financial Systems Should be Strengthened (Repeat Condition).
- Management of Trade Activities and Related Systems at Customs Needs Improvement (Repeat Condition)
- Financial Management Services' (FMS) Controls Over Outstanding Checks Need Improvement

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Our audit disclosed the following reportable instances of noncompliance with laws and regulations, exclusive of the Federal Financial Management Improvement Act of 1996 (FFMIA):

- IRS did not release Federal tax liens in accordance with Section 6325 of the Internal Revenue Code (IRC) (Repeat Condition).
- IRS' installment agreements are not in compliance with Section 6159 of the IRC.
- Customs did not make recommendations on revising the fees and charges for its reimbursable projects as required by the Chief Financial Officers Act of 1990 (CFO Act) (Repeat Condition).
- Customs did not report to Congress recommendations for fee adjustments as required by Title 19 of the U.S. Code, Section 58c(f)(4) (Repeat Condition).
- The Air Transportation Stabilization Board (ATSB) obligated funds for a Federal loan guarantee in violation of the Anti-Deficiency Act.

In addition, the Department's financial management systems did not substantially comply with Federal Financial Management Systems Requirements (FFMSR), Federal accounting standards, and the United States Government Standard General Ledger (SGL) at the transaction level as required under FFMIA (Repeat Condition).

## **Management's Responsibilities**

Management is responsible for:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America.
- Preparing the Management Discussion and Analysis (MD&A) of the Department, Supplemental Information, Other

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Accompanying Information and the Full Report of Treasury's FY 2002 Measures by Strategic Goal.

- Establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the benefits and related costs of internal accounting policies and procedures.
- Complying with laws and regulations applicable to the Department.

## Scope of Audit

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements* (OMB Bulletin No. 01-02). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

Our responsibility is to express an opinion on the financial statements based on our audits. We did not audit the financial statements of the IRS or the Bureau of the Public Debt's (BPD) Schedules of Federal Debt for the years ended September 30, 2002 and 2001, the accounts for which are included in the Department's financial statements. The IRS' financial statements for the years ended September 30, 2002 and 2001 included custodial revenues of \$2.0 trillion and \$2.1 trillion, total assets of \$24.7 billion and \$25.2 billion, and net costs of operations of \$10.0 billion and \$9.3 billion, respectively. BPD's Schedules of Federal Debt for the years ended September 30, 2002 and 2001 included Federal debt and interest payable of \$6.2 trillion and \$5.8 trillion, and interest expense of \$334 billion and \$362 billion,

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respectively. These accounts were audited by another auditor whose reports were furnished to us, and our opinion, insofar as it relates to the amounts included in IRS' financial statements and BPD's Schedules of Federal Debt for the years ended September 30, 2002 and 2001, is based solely on the reports of the other auditor. We believe that our audits and the reports of the other auditor provide a reasonable basis for our opinion and our conclusions on internal control and compliance with laws and regulations.

In planning and conducting our audit of the Department's financial statements, we considered its internal control over financial reporting by obtaining an understanding of the design of the Department's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

In addition, with respect to internal controls related to performance measures reported in the MD&A and the Full Report of Treasury's FY 2002 Measures by Strategic Goal, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions and determined whether they had been placed in operation. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Department's compliance with: (1) certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of

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financial statement amounts; and (2) certain other laws and regulations, specified in OMB Bulletin No. 01-02, including the requirements referred to in FFMIA. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the Department. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes. Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

Under FFMIA, we are required to report whether the Department's financial management systems substantially comply with the following three general requirements: FFMSR, applicable Federal accounting standards, and the SGL at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a).

## **Results of Audit**

### **Opinion on the Financial Statements**

In our opinion, based on our audits and the reports of the other auditor, the Department's financial statements present fairly, in all material respects, its assets, liabilities, and net position as of September 30, 2002 and 2001, its net costs and custodial activities for the years then ended, and the changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the year ended September 30, 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 32 to the Department's financial statements, adjustments of \$3.1 billion to restate cash, foreign currency & other monetary assets; and, \$1.0 billion to restate unexpended appropriations, were made to the previously reported balances as of September 30, 2001.

The MD&A and Supplemental Information are not required parts of the financial statements but are required by accounting principles

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generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the MD&A and Supplemental Information. However, we did not audit the MD&A and Supplemental Information and express no opinion on them.

Our audits were conducted for the purpose of expressing an opinion on the Department's financial statements referred to above. The Other Accompanying Information and the Full Report of Treasury's FY 2002 Measures by Strategic Goal are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements, and accordingly, we express no opinion on it.

## **Internal Control**

Internal control is a process, effected by the Department's management and other personnel, designed to provide reasonable assurance that the following objectives are met:

- Reliability of financial reporting - transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and the safeguarding of assets against loss from unauthorized acquisition, use, or disposition;
- Compliance with applicable laws and regulations - transactions are executed in accordance with: (1) laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements, and (2) any other laws and regulations, identified in OMB Bulletin No. 01-02; and
- Reliability of performance reporting - transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

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Because of limitations inherent in any internal control, errors or fraud may occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that internal control may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

As defined in OMB Bulletin No. 01-02, reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of the internal control that could adversely affect the Department's ability to meet the internal control objectives as defined above. Material weaknesses are reportable conditions in which the design or operation of the internal control does not reduce to a relatively low level the risk that errors, fraud, or noncompliance in amounts that would be material in relation to the financial statements being audited or material to a performance measure or aggregation of related performance measures may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We identified the following matters involving the internal control and its operation that we consider to be material weaknesses as defined above. Weaknesses that we identified in our report, *Audit of the Department of the Treasury's Fiscal Year 2001 and 2000 Financial Statements* (OIG-02-054, issued February 27, 2002) that continued to exist during fiscal year (FY) 2002, are identified as "Repeat Condition."

### **Material Weaknesses**

#### **Financial Management and Reporting at the IRS Needs Improvement (Repeat Condition)**

IRS continues to face many of the pervasive internal control weaknesses that have been reported each year since its financial statements were first subjected to audit in fiscal year 1992. Despite these weaknesses, IRS was able to produce financial statements covering its tax custodial and administrative activities that are fairly stated in all material respects. However, because of



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serious systems and internal control weaknesses, IRS had to rely on costly compensating processes, statistical projections, external contractors, substantial adjustments, and labor intensive efforts to prepare reliable financial statements. These costly efforts would not have been necessary if IRS' systems and controls had operated effectively.

IRS has made progress in improving its financial management, however, it will be difficult for IRS personnel to sustain the level of effort needed to produce reliable financial statements timely without addressing the underlying systems and internal control weaknesses. Additionally, this process does not produce the reliable, useful, and timely financial and performance information IRS needs for decision making on an ongoing basis, nor can it fully address the underlying financial management and operational issues that adversely affect IRS' ability to effectively fulfill its responsibilities as the nation's tax collector.

The challenge for IRS will be to continue the improvements made in recent years and to develop and implement the fundamental long-term solutions that are needed to address its internal control weaknesses. Some of these solutions can be addressed in the near term, however, others, which involve modernizing IRS' financial and operational systems, will take years to fully achieve.

The material weaknesses in internal control identified during the fiscal year 2002 IRS audit, all of which are repeat conditions, are summarized as follows:

- Weaknesses in controls over the financial reporting process, resulting in IRS not (1) being able to prepare reliable financial statements without extensive compensating procedures or (2) having current and reliable ongoing information to support management decision making and to prepare cost-based performance measures;
- Weaknesses in controls over unpaid tax assessments, resulting in IRS' inability to properly manage unpaid assessments and leading to increased taxpayer burden;

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- Weaknesses in controls over the identification and collection of tax revenues due the federal government and over the issuance of tax refunds, resulting in potentially billions of dollars in improper payments and lost revenue to the Federal government;
  - Weaknesses in controls over property and equipment, resulting in IRS' inability to have reliable and timely information on its balance of property and equipment throughout the year and to reasonably ensure that its property and equipment are safeguarded and used only in accordance with management policy; and
  - Weaknesses in computer security controls, resulting in increased risk of unauthorized individuals being allowed to access, alter, or abuse proprietary IRS programs and electronic data and taxpayer information.

The material weaknesses in internal control noted above may adversely affect any decision by IRS' management that is based, in whole or in part, on information that is inaccurate because of these weaknesses. Also, unaudited financial information reported by IRS, including budget and performance information, may also contain misstatements resulting from these weaknesses.

In addition, two other reportable conditions were identified related to deficiencies in controls over (1) budgetary activity, and (2) hard-copy tax receipts and taxpayer data. In prior audits, the deficiency in controls over budgetary activity was reported as a material weakness, but based upon improvements identified during the fiscal year 2002 audit, this weakness was reassessed as a reportable condition.

#### **Recommendations:**

Recommendations to address the weaknesses discussed above have been provided to the IRS. We reaffirm our prior year recommendation that the Assistant Secretary for Management and Chief Financial Officer ensures that IRS develops and implements an appropriate corrective action plan that will fully address the

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material weaknesses and reportable condition identified in the audit of its financial statements.

**EDP Controls Over Financial Systems Should be Strengthened  
(Repeat Condition)**

Material weaknesses in EDP controls were identified at IRS, FMS, Customs, and the U.S. Mint (Mint). In addition, other reportable conditions related to EDP controls were identified at the Bureau of Alcohol, Tobacco and Firearms (ATF), and the Office of the Comptroller of the Currency (OCC). The details of these EDP weaknesses and audit recommendations were, or will be, provided to respective bureau management separately, and in some instances, due to the sensitive nature of the weaknesses, in separate reports with limited official distribution.

**General Controls**

EDP general controls, which provide the structure, policies and procedures that apply to the Department's overall computer operations, need to be strengthened. The absence of effective general controls over computer based financial systems makes the Department vulnerable to losses, fraud, delays, or interruptions in service, and compromises the integrity and reliability of the information systems and data. Significant EDP general control weaknesses by major category are summarized below.

Entity-wide security program planning and management

Specific control weaknesses included (1) inadequate security planning and implementation, (2) insufficient technical security-related training for key personnel, and (3) inadequate follow-up monitoring to ensure that internal control deficiencies are considered and addressed entity-wide. The entity-wide security program planning and management process provides for identifying and assessing risks, deciding what policies and controls are needed, periodically evaluating the effectiveness of these policies and controls, and acting to address any identified weaknesses.

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### Access control

Deficiencies existed in physical and logical access controls over computer resources (data files, application programs, and computer-related facilities and equipment) that protect against unauthorized modification, disclosure, loss, or impairment. Access control weaknesses make systems vulnerable to damage and misuse by allowing individuals and groups to inappropriately modify, destroy, or disclose sensitive data or computer programs for purposes such as personal gain or sabotage.

### Application software development and change control

Policies and procedures to identify, select, install, and modify software were not followed, and controls over infrastructure changes were not fully documented. Application software development and change controls prevent unauthorized software programs or modifications to programs from being implemented.

### System software

System software control weaknesses included (1) policies and procedures for restricting access to system software and monitoring the use of system utilities had not been developed, (2) review of system utility logs were not always performed, and (3) key networks and systems were not routinely monitored. System software controls limit and monitor access to the powerful programs and sensitive files associated with the computer systems operation.

### Segregation of duties

Segregation of duties weaknesses related to system and security administration. Segregation of duties refers to the policies, procedures, and organizational structure that help ensure that one individual cannot independently control key aspects of a processor computer-related operation, and thereby conduct unauthorized actions or gain unauthorized access to assets or records without detection.

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### Service continuity

Several significant deficiencies, including insufficient planning and testing, could impair timely restoration of mission-critical systems. Service continuity controls ensure that when unexpected events occur, critical operations continue without undue interruption and critical and sensitive data are protected.

### **Application Controls**

Application controls provide assurance that transactions are valid, properly authorized, and completely and accurately processed and reported, and include (1) programmed control techniques, such as automated edits, and (2) manual follow-up of computer-generated reports, such as reviews of reports identifying rejected or unusual items.

Based on limited testing of application controls at certain bureaus, additional weaknesses were identified related to (1) the completeness, integrity, and availability of internal financial reports, (2) logical user access rights and privileges for business applications that were not sufficiently defined based on appropriate job duties or responsibilities, (3) ascertaining the validity and authority of changes to inventory valuation, and (4) segregating critical financial applications and information systems duties.

### **Recommendations:**

Recommendations were, or will be, provided to bureau management to address these conditions. We reaffirm our prior year audit recommendation that the Department's Chief Information Officer should provide effective oversight to ensure that the specific recommendations detailed in the above referenced reports, and the related plans for corrective actions, are implemented completely and timely by the various bureaus.

### **Management of Trade Activities and Related Systems at Customs Needs Improvement (Repeat Condition)**

Ongoing weaknesses in the design and operation of Customs' controls over trade activities and financial management and

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information systems continue to inhibit the effective management of these activities and protection of trade revenue. Many of these weaknesses have been reported since Customs' financial statements were first subjected to audit in FY 1992. Material weaknesses identified during the FY 2002 audit work at Customs are summarized below:

- Customs' core financial systems did not provide certain critical financial information necessary for managing operations. Also, the financial systems did not capture all transactions as they occurred during the year, did not record all transactions properly, and were not fully integrated. Additionally, the systems did not always provide for essential controls with respect to override capabilities and changes to system data. As a result, extensive manual procedures and analyses were required to process certain routine transactions and prepare year-end financial statements.
- IT system logical access and software maintenance security controls need improvement. Network and host based system configuration vulnerabilities exist that can potentially be used to compromise system security. Also, deficiencies were identified in logical access controls over data files, application programs, and computer-related facilities and equipment.
- Controls over the entry process need improvement. Compliance measurement was not performed during the majority of FY 2002. Consequently, Customs lacked a statistically valid measurement of the effectiveness of its system of internal controls over the entire entry process. In addition, inspections of merchandise and reviews of importer and/or broker submitted entry documentation were non-statistical and could not be used to measure the overall extent of trade compliance. The lack of statistical measurement hindered Customs ability to determine the extent of Customs compliance with laws and regulations, and to measure the revenue gap (i.e., the difference between the what was and what should have been collected). There

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were also deficiencies in manual control activities performed by various port personnel.

- Drawback controls need to be strengthened. The system that handles drawback claims cannot perform critical comparisons of key information, or detect duplicate drawbacks. In addition, the process used to select drawback claims for review, as implemented, cannot produce a statistically valid projection of the results or a measure of the effectiveness of controls.

In addition, four other reportable conditions were identified related to (1) bonded warehouse and foreign trade zones operations reviews, (2) monitoring and measuring compliance of in-bond movements, (3) the impact of the events of September 11, 2001 on internal controls over the drawback process, and (4) entity-wide security program documentation.

### **Recommendations**

Recommendations to address the weaknesses discussed above have been provided to Customs. We recommend that the Assistant Secretary for Management and Chief Financial Officer ensures that Customs develops and implements appropriate corrective action plans that will fully address the conditions noted above.

### **FMS' Controls Over Outstanding Checks Need Improvement**

FMS did not have adequate controls over the summary dollar totals of outstanding checks (i.e. checks issued that have not been paid or cancelled). As a result, the operating cash of the Federal government was overstated by \$3.1 billion. The following specific matters pertaining to outstanding checks were noted:

- Until recently, FMS was unable to produce a detail of outstanding checks as of a given date. Such detail is necessary to maintain an adequate audit trail over these items, and for reconciliation purposes.

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- FMS did not reconcile the balance of outstanding checks in STAR (the general ledger) to the amount contained in the Check Payment and Reconciliation (CP&R) system, which records the details of check issuance and payments.
  - The Check Issue Audit Reconciliation Report is used to reconcile the total of checks issued as recorded in STAR to the total contained in CP&R and identify all timing differences between the two systems. However, not all reconciling items affecting STAR were investigated and adjusted in the proper period.
  - There are insufficient reconciliation procedures between CP&R and the Payments, Claims and Enhanced Reconciliation (PACER) system, a system that contains check status related data.

FMS has not been able to determine the cause of the misstatement or when it first occurred. However, it has been determined that the understatement of outstanding checks dates back at least to September 30, 2000. Consequently, a prior period adjustment reducing the operating cash of the Federal government by \$3.1 billion was posted to correct this error.

#### **Recommendations:**

Recommendations to address this weakness have been provided to FMS. We recommend that the Assistant Secretary for Management and Chief Financial Officer ensures that FMS develops and implements an appropriate corrective action plan that will fully address this material weakness.

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Our consideration of internal control would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.



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## Compliance with Laws and Regulations

The results of our tests of compliance with laws and regulations, exclusive of FFMIA, disclosed the following instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards*, and OMB Bulletin No. 01-02:

- The IRC grants IRS the power to file a lien against the property of any taxpayer who neglects or refuses to pay all assessed Federal taxes. Under Section 6325 of the IRC, IRS is required to release a Federal tax lien within 30 days after the date the tax liability is satisfied, has become legally unenforceable, or the Secretary of the Treasury has accepted a bond for the assessed tax. The FY 2002 audit identified instances in which taxpayers' total outstanding tax liabilities were either paid off or abated and IRS did not release the applicable Federal tax lien within the 30 day requirement stipulated by the IRC. (Repeat Condition)
- Section 6159 of the IRC authorizes IRS to enter into installment agreements with taxpayers to fully satisfy the taxpayer's tax liability. During the FY 2002 audit, instances were identified where installment agreements were not structured to provide for full payment of the tax liability within the statutory collection period. Audits prior to FY 2001 also identified similar noncompliance.
- The CFO Act requires that a biennial review be performed of fees and other charges imposed for services and things of value, and that recommendations be made to the head of the agency on revising those charges to reflect costs incurred in providing those services and things of value. During FY 2001, Customs conducted a review and analysis of these fees, but did not make recommendations for revising the fees. In FY 2002, recommendation was made that legislation be introduced to revise user fees to reflect actual costs related to providing services. However, specific fee recommendations were not made for each activity. (Repeat Condition)

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- Title 19 of the U.S. Code, Section 58c(f)(4), requires a biennial review, for each even-numbered fiscal year, of the adequacy of the fees charged for the provision of certain Customs services, as well as the fees charged for the processing of merchandise. The statute requires that Customs prepare a report for Congress, based on its review, that makes recommendations on how the fees should be adjusted. Customs has not reported to Congress recommendations on adjustments to the fees.  
(Repeat Condition)
  - The Anti-Deficiency Act prohibits obligating funds in advance of available appropriations. ATSB violated the Anti-Deficiency Act when it obligated funds for a Federal Loan guarantee before the Presidential designation of these budgetary resources as “emergency requirements” had been effected pursuant to the Balanced Budget and Emergency Deficit Control Acts. As a result, budget authority was not available for obligation by ATSB. This violation was subsequently remedied when the President executed the necessary designation.

Except for the instances described above, the results of our tests of compliance disclosed no other instances of noncompliance with other laws and regulations, exclusive of FFMIA, that are required to be reported under *Government Auditing Standards*, and OMB Bulletin No. 01-02.

The results of our tests disclosed instances where the Department’s financial management systems did not substantially comply with FFMIA section 803(a) requirements related to compliance with FFMSR, applicable Federal accounting standards and the SGL at the transaction level. (Repeat Condition)

Instances of noncompliance with FFMSR are summarized below:

- IRS’ financial management systems do not provide timely and reliable information for financial reporting and preparation of financial statements. IRS had to depend extensively on labor intensive compensating procedures to generate reliable financial statements. In addition, IRS lacks

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a subsidiary ledger for its unpaid assessments; lacks a reliable subsidiary ledger for its property and equipment; and lacks an effective audit trail from its general ledger back to subsidiary detailed records and transaction source documents for material balances.

- Customs' core financial systems do not provide complete and accurate information for financial reporting and preparation of financial statements. Extensive manual procedures and analyses were required to process certain routine transactions and prepare year-end financial statements. Furthermore, certain feeder systems are not fully integrated or electronically interfaced with Customs' general ledger system.
- The material weakness *EDP Controls Over Financial Systems Should be Strengthened* related to EDP controls at IRS, Customs, FMS and Mint, discussed above.

Instances of noncompliance with Federal accounting standards are summarized below:

- Material weaknesses at IRS related to controls over unpaid tax assessments, tax revenue and refunds, and property and equipment.
- Material weaknesses at Customs related to controls over the entry process and drawback claims.
- Material weakness at FMS related to controls over outstanding checks.

Instances of noncompliance with the SGL at the transaction level requirements are described below:

- IRS' general ledger system comprises two independent general ledgers that are not integrated with each other nor with their supporting records for material balances, and does not use the standard Federal accounting classification structure for custodial activities.

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- Certain Customs' transactions are not properly recorded in the general ledger as they occur. For example, (1) reimbursable transactions were initially recorded in the general ledger as though they were appropriated transactions, and (2) liabilities were not recorded in the general ledger upon receipt of goods and services.

The Secretary of the Treasury also has determined in the Secretary's Letter of Assurance, in Part 4 of the accompanying *FY 2002 Performance and Accountability Report*, that the Department cannot provide assurance that its financial management systems are in substantial compliance with FFMIA. The Department's remedial actions and related timeframes are also presented in Part 4.

FFMIA requires that if the head of an agency determines that its financial management systems do not substantially comply with FFMIA, a remediation plan must be developed, in consultation with OMB, that describes the resources, remedies, and intermediate target dates for achieving substantial compliance. FFMIA also requires OMB concurrence with any plan not expected to bring the agency's system into substantial compliance with the FFMIA no later than three years after a determination of noncompliance is made. The Department received a waiver from OMB for Customs and IRS for the requirement to bring financial management systems into substantial compliance within the three year timeframe.

Customs' FFMIA remediation plan includes planned remedial actions and associated target dates. Since OMB's waiver was received, funding for two of the key remedial actions has been insufficient. Therefore, Customs has extended its remediation plan completion date further, without consent of the Department and OMB. We believe that Customs should develop alternative actions and plans wherever possible to address the funding uncertainties and extended timeframes related to these remedial actions. Modification to Customs' remediation plan should be reviewed and approved by the Department and submitted to OMB for concurrence.

IRS has established a remediation plan to address the conditions affecting its systems' ability to comply with the requirements of

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FFMIA. This plan outlines the actions to be taken to resolve these issues, designates resources to be devoted to implementing those actions, and specifies timeframes for their completion. Due to the long term nature of IRS' systems modernizations efforts, many of the planned timeframes exceed the three-year resolution period specified in FFMIA.

**Recommendations:**

We recommend that the Assistant Secretary for Management and Chief Financial Officer: (1) ensures that IRS implements appropriate controls so that Federal tax liens are released in accordance with Section 6325 of the IRC; (2) ensures that IRS addresses the noncompliance with Section 6159 of the IRC; (3) ensures that Customs is in full compliance with the requirements of the CFO Act and Title 19 of the U.S. Code, Section 58c(f)(4); (4) ensures that ATSB implements controls to ensure budget authority is available before funds are obligated; and (5) continues to monitor and assess progress of the bureaus in developing and implementing their remediation plans to address the identified instances of financial management systems noncompliance with the requirements of FFMIA, and in taking appropriate actions when key target dates are not met.

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\* \* \* \* \*

We have reviewed our findings and recommendations with the Department's financial management and have incorporated their comments as appropriate. The response to our audit report from the Assistant Secretary for Management and Chief Financial Officer is included in Appendix 1 of this report.

This report is intended solely for the information and use of the management of the Department, OMB, the U.S. General Accounting Office, and the Congress, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is available to the public as a matter of public record.

/s/

William H. Pugh  
Deputy Assistant Inspector General for Financial Management  
and Information Technology Audits  
November 8, 2002

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DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C.

ASSISTANT SECRETARY

November 13, 2002

**MEMORANDUM FOR JEFFREY RUSH, JR.**  
**INSPECTOR GENERAL**

**FROM:** Edward R. Kingman, Jr. /s/  
Assistant Secretary for Management  
and Chief Financial Officer

**SUBJECT:** Management Response –Report of the Office of Inspector General on  
the Department of the Treasury's Fiscal Year (FY) 2002 Financial Statements

On behalf of Secretary O'Neill, I am responding to your audit report on the Department's FY 2002 financial statements included in Treasury's FY 2002 Performance and Accountability Report.

We appreciate your highly successful efforts to audit the Department's fiscal year 2002 financial statements and provide timely, objective advice on how to improve our financial reporting processes. Over the past several years, our offices have worked diligently together to achieve significant results – the initial unqualified opinion the Department received on its financial statements for fiscal year 2000, followed by unqualified opinions for FYs 2001 and 2002, and, equally significant, the acceleration of the Department's report issuance date from five months for FY 2001 to forty-five days for FY 2002.

As noted in your report, accelerating the issuance of the Department's Performance and Accountability Report to November 15, 2002, while maintaining an unqualified audit opinion, is an extraordinary accomplishment. All of our bureaus played a key role in this accomplishment, and we are especially appreciative of the dedicated level of professional assistance, enthusiasm, and plain hard work demonstrated by your office throughout the audit process. Completing the Department's audit on such an extremely compressed schedule is a testimony to that dedication. We recognize that achieving an unqualified audit opinion was accomplished only by employing, in several critical areas, labor intensive procedures in order to compensate for systems deficiencies. We agree that we still have much work to do to improve our financial reporting and financial management, and that several of our financial systems need to be upgraded or replaced in order to allow for the production of timely, reliable financial data throughout the year. These systems improvements are also necessary to reduce the heavy workload on our respective staffs that is currently necessary to produce the financial statements, especially on an accelerated basis. To this end, we need to place even greater emphasis on addressing our management control deficiencies, especially as they relate to financial systems.

We concur with the four Departmental level material weaknesses and the instances of noncompliance with laws and regulations contained in your report. We have already initiated corrective actions to address several of these matters, especially with regards to financial management and reporting at the IRS, EDP controls, and noncompliance with the Federal Financial Management Improvement Act. We will strive to continue and improve our efforts in these areas, and will provide you with corrective action plans to address all the findings contained in your report.

I am confident that the professional, positive working relationship between our offices, and also with the Treasury Inspector General for Tax Administration and the General Accounting Office, will allow us to build on this year's successes and continue to improve financial management across the Department.



**Office of Management and Budget**

Director, Office of Management and Budget

**United States Senate**

Chairman, Subcommittee on Treasury, Postal Service and  
General Government, Committee on Appropriations  
Ranking Member, Subcommittee on Treasury, Postal Service  
and General Government, Committee on Appropriations  
Chairman, Committee on Governmental Affairs  
Ranking Member, Committee on Governmental Affairs

**United States House of Representatives**

Chairman, Subcommittee on Treasury, Postal Service and  
General Government, Committee on Appropriations  
Ranking Minority Member, Subcommittee on Treasury, Postal  
Service and General Government, Committee on  
Appropriations  
Chairman, Committee on Government Reform  
Ranking Minority Member, Committee on Government Reform

**United States General Accounting Office**

Comptroller General of the United States

**SECTION II –**

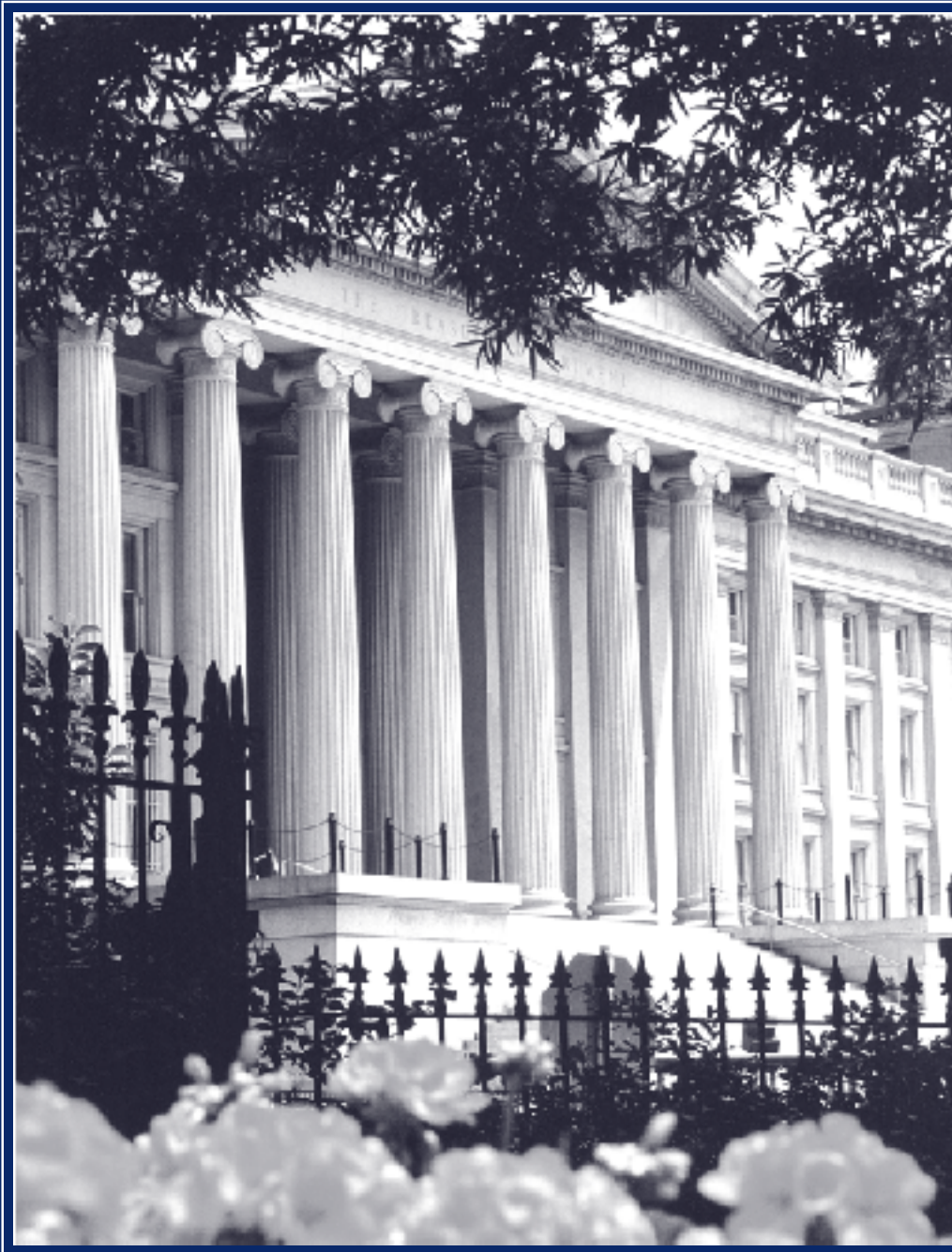
**DEPARTMENT OF THE TREASURY'S  
PERFORMANCE AND ACCOUNTABILITY REPORT  
FOR FISCAL YEAR 2002**

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# PERFORMANCE AND ACCOUNTABILITY REPORT

Volume I

FY 2002



Department of the Treasury

See the following website for the FY 2002 Treasury Performance & Accountability Report.

Volume I:

<http://www.treas.gov/offices/management/budget/performance/2002/2002vol1.pdf>

# PERFORMANCE AND ACCOUNTABILITY REPORT

Volume II

FY 2002



Department of the Treasury

See the following website for the FY 2002 Treasury Performance & Accountability Report.

Volume II:

<http://www.treas.gov/offices/management/budget/performance/2002/2002vol2.pdf>